AUDITOR-GENERAL
SOUTH AFRICA

BUDGETARY REVIEW AND RECOMMENDATIONS REPORT (BRRR):

Portfolio Committee on Public Enterprises

October 2022

Briefing document on the audit outcomes for the Public Enterprises portfolio: 2021-22

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1. Introduction

1.1 Reputation promise of the Auditor-General of South Africa

The Auditor-General of South Africa (AGSA) has a constitutional mandate and, as the supreme audit institution of South Africa, exists to strengthen our country’s democracy by enabling oversight, accountability and governance in the public sector through auditing, thereby building public confidence.

1.2 Role of the AGSA

Our role as the AGSA is to reflect on the audit work performed to assist the portfolio committee in its oversight role of assessing the performance of entities, taking into consideration the committee’s objective to produce a budgetary review and recommendations report (BRRR).

1.3 Role of the portfolio committee

Section 5(2) of the Money Bills Procedures and Related Matters Amendment Act 9 of 2009 allows for each committee to compile a BRRR, which must be tabled in the National Assembly. Section 5(3) provides for a BRRR to contain the following:

- An assessment of entities’ service delivery performance given available resources
- An assessment of the effectiveness and efficiency of entities’ use and further allocation of available resources
- Recommendations on the further use of resources.

1.4 Mandate of the AGSA and the portfolio committee

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AGSA mandate	Portfolio committee mandate

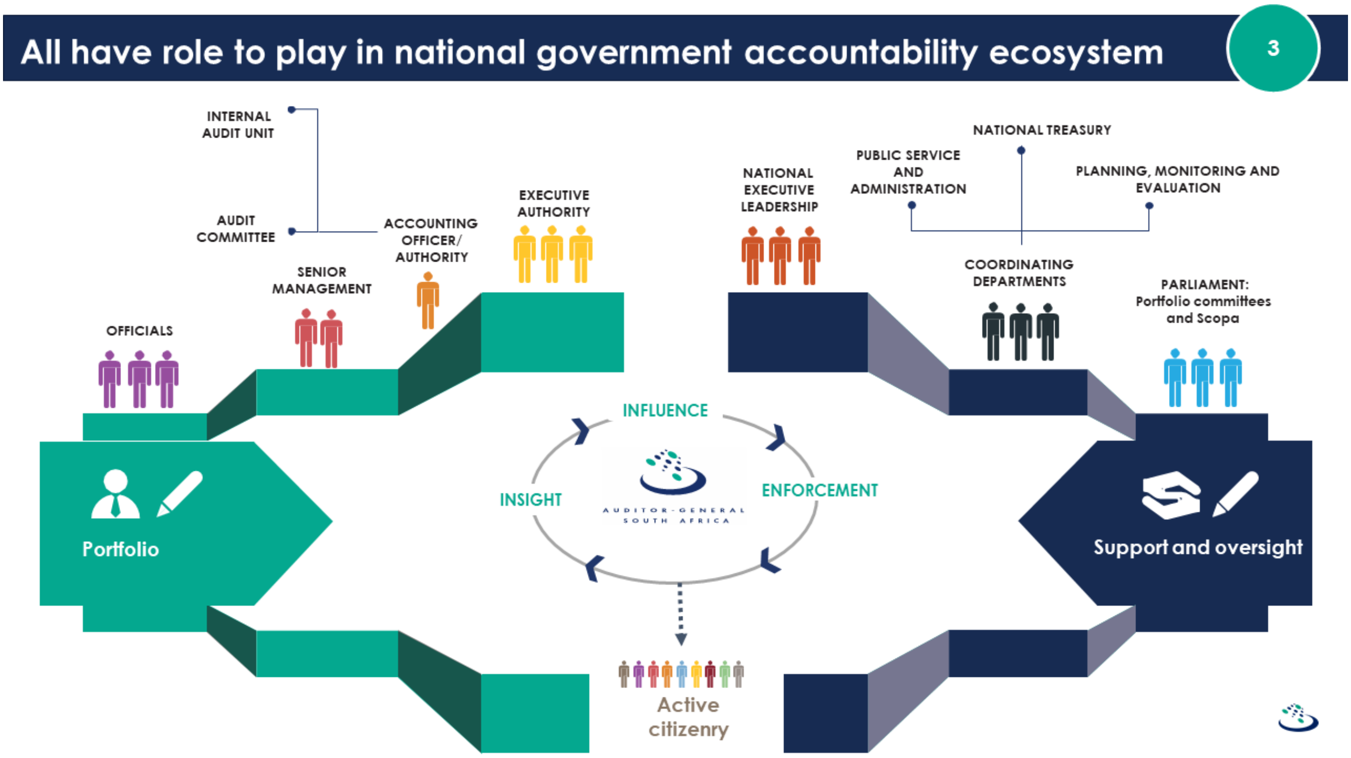
Section 188 of the Constitution
The AGSA must audit and report on the accounts, financial statements and financial management of government institutions.
Section 20(2) of the Public Audit Act (PAA)
• The AGSA must prepare an audit report containing an opinion/conclusion on the:
  ○ fair presentation of the financial statements
  ○ compliance with applicable legislation
  ○ reported performance against predetermined objectives.
• Discretionary audits (including special audits, investigations and performance audits).
Section 5(1B) of the PAA
The auditor-general has the power to:
• issue a notification of a material irregularity
• include recommendations in the audit report
• take an appropriate remedial action
• issue a certificate of debt, as prescribed, where an accounting officer/authority has failed to comply with remedial action.
	National Assembly Rule 227
	Portfolio committees may, among other things, perform the following functions:
	• Deal with bills and other matters falling within their portfolio, as referred to them in terms of the Constitution, legislation or rules, or by resolution of the assembly
	• Maintain oversight of their portfolios of national executive authority, including implementation of legislation, any executive organ of state falling within their portfolios, any constitutional institution falling within their portfolios, and any other body or institution in respect of which oversight was assigned to them
	• Consult and liaise with any executive organ of state or constitutional institution
	• Monitor, investigate, inquire into and make recommendations concerning any such executive organ of state, constitutional institution or other body or institution, including the legislative programme, budget, rationalisation, restructuring, functioning, organisation, structure, staff and policies of such organ of state, institution or other body or institution
	• Consult and liaise with any executive organ of state or constitutional institution
	• Perform any other functions, tasks or duties assigned to them in terms of the Constitution, legislation, these rules, the joint rules or resolutions of the assembly, including functions, tasks and duties concerning parliamentary oversight or supervision of such executive organs of state, constitutional institutions or other bodies or institutions.

1.5 Purpose of this document

The purpose of this briefing document is for the AGSA to reflect on the audit outcomes to assist the portfolio committee in its oversight role of assessing the performance of entities, taking into consideration the objective of the committee to produce a BRRR.

1.6 Shifting the public sector culture through the accountability ecosystem

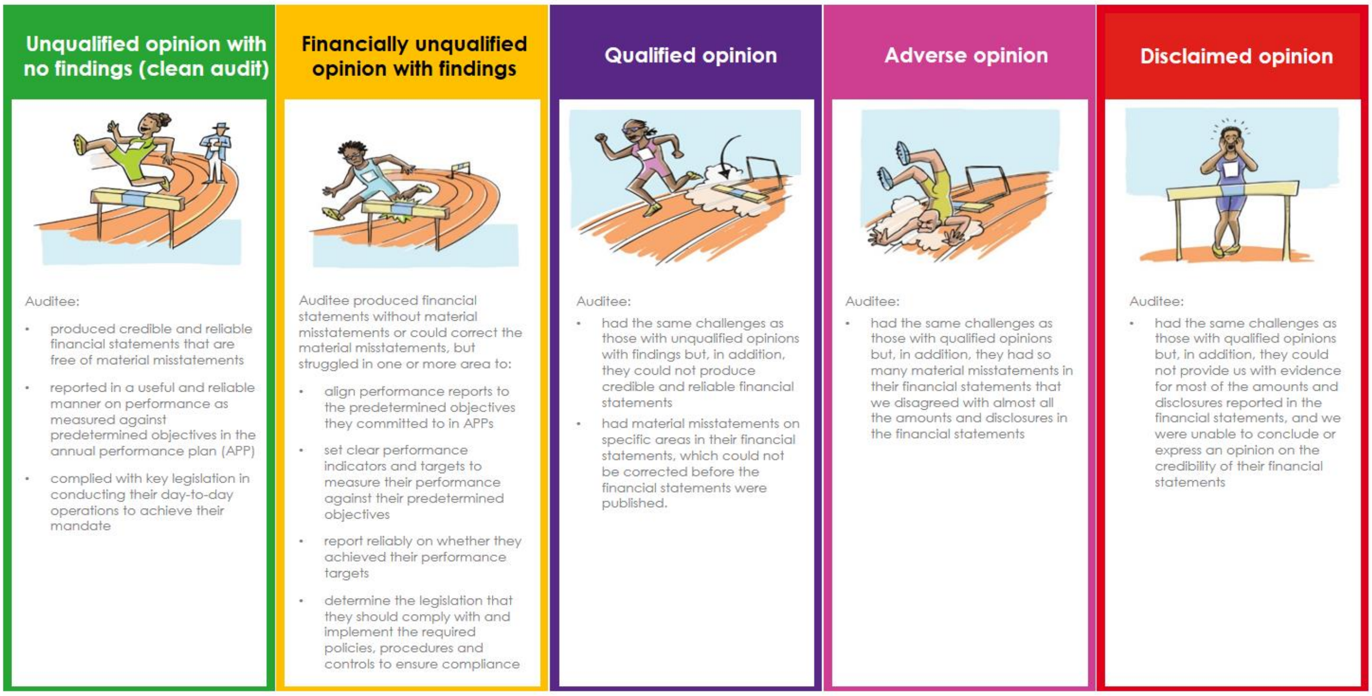
Slide 3



- *The accountability ecosystem is the network of stakeholders that have a mandate and/or responsibility, whether legislative or moral, to drive, deepen and/or insist on public sector accountability.*
- *A more active and engaged accountability ecosystem would add to the much-needed effort of shifting public sector culture and would alleviate the over-reliance on the AGSA to assume responsibility for improving audit outcomes and enforcing consequences.*

- *Shifting the public sector culture towards one that is characterised by performance, accountability, transparency and integrity can only be accomplished if all role players in the broader accountability ecosystem fulfil their respective responsibilities and mandates.*
- *Given the nature of the AGSA's mandate, by the time that we audit the financial statements of auditees and report on adverse findings, multiple failures have already occurred along the accountability value chain. After our audits, other steps are required to complete the accountability cycle.*
- *Improvement in sound financial management to enhance the lives of citizens does not only reside within the domain and responsibility of the accounting officer or authority and the auditors. It depends on the entire accountability ecosystem to enable a culture of accountability in a sustainable and meaningful way.*

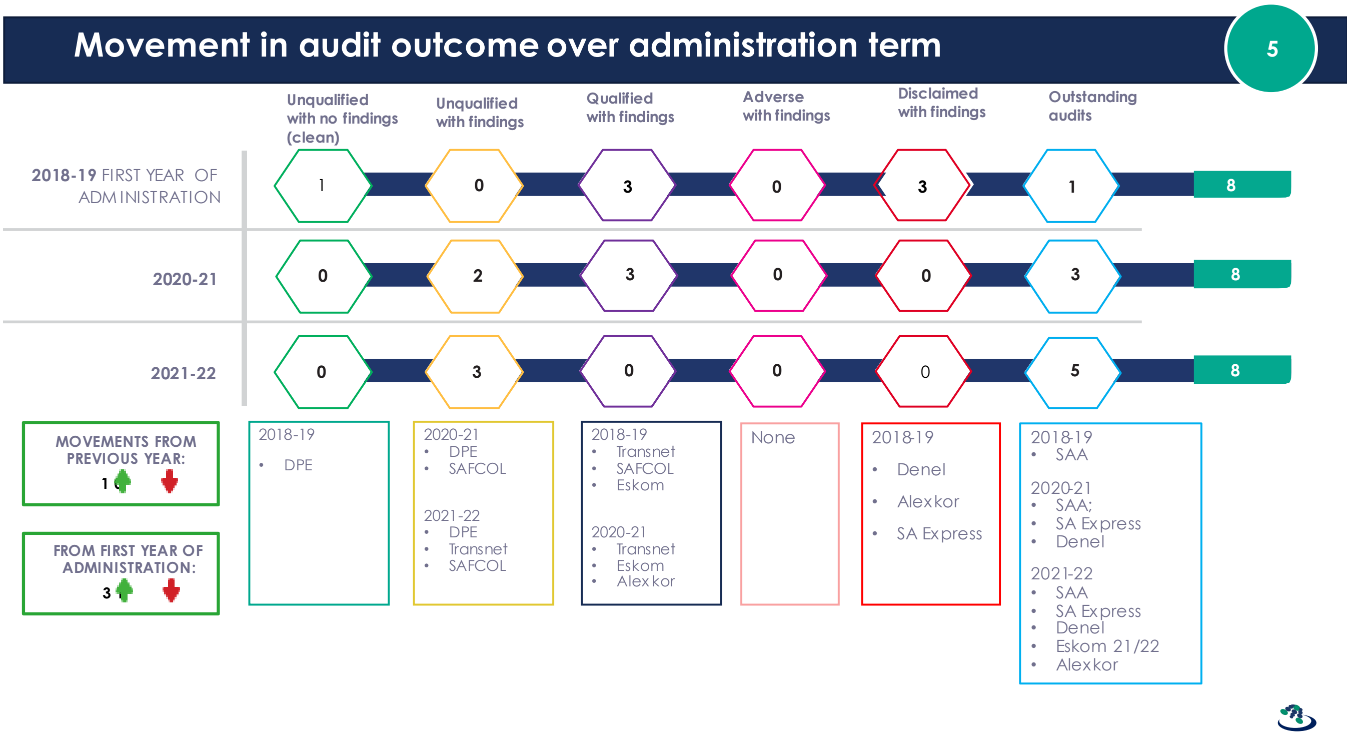
1.7 Audit outcomes explained



2. Movement in audit outcomes over administration term

Slides 5 & 6

Four-year audit outcomes



2.1 Overview

At the start of the current administration, the department had received the most favourable audit outcome, namely unqualified with findings. Transnet, Safcol and Transnet were all qualified while Denel, SA Express and Alexkor received disclaimers of audit opinion.

We noted three improvements over time since then, based on the latest available outcome. Alexkor has moved to qualified (2020-21) from a disclaimer, while Safcol and Transnet moved from qualified to unqualified with findings. The DPE has regressed from a clean audit to unqualified with findings.

Regrettably, the number of outstanding audits has increased from one to five (SAA, SA Express, Alexkor, Denel and Eskom). We will reflect more on these shortly.

Comparing the current year to the prior year, Transnet managed to move from a qualification to unqualified with findings as a result of the exemption granted by National Treasury. The entity is exempt from including PFMA disclosures in the notes to the financial statements.

As indicated, the outstanding audits have increased significantly from one to five. The following is the list of those audits currently outstanding and reasons for this.

South African Airways (SAA):

The audit of SAA has been outstanding since 2018-19 due to business rescue processes. The entity recently submitted their annual financial statements for the past four years and the catch-up audits have commenced.

South African Express Airways (SAX):

Annual financial statements have not been submitted for three financial years. The entity has been liquidated.

Denel:

Annual financial statements have not been submitted for the past two years due to financial and operational challenges. The entity committed to submit their 2020-21 financial statements by 30 November 2022.

The entity is currently in contravention of the PFMA and the Companies Act having failed to submit financial statements for auditing for two consecutive financial years.

Eskom:

The audit was delayed as a result of various issues, including late submission of information and adjustments of misstatements identified during the audit.

Alexkor

The prior year audit was signed off late in March 2022. There were also delays with the reappointment of the auditors.

2.2 Detail on outcomes – only for three audits concluded

Overview

2.2.1 Findings on the audit of the annual performance report and achievement of targets

Slides 7 – 9

In 2019, government published the Medium-Term Strategic Framework which outlines strategic priorities. In slide 8, we list three of these priorities relating to the DPE portfolio as follows:

- Intervention: Repurpose SOEs, strengthen governance systems and ensure board stability
    - Target: Annual scorecard on the repurposing of SOEs by the end of 2021
    - Target: Main infrastructure SOEs repurposed by March 2022
- Intervention: Separation and unbundling of Eskom to eliminate cross-subsidisation and improve efficiency
    - Target: transmission company established – Legal separation completed by 2022-23
- Intervention: Reduce costs for priority sectors by increasing the efficiency of ports
    - Target: Transnet National Ports Authority Corporatisation completed by March 2022-23.

We are highlighting these to remind government and parliament of these priorities. Parliament's oversight should follow up on progress made against these priorities.

Performance reporting and achievement of targets

All three institutions (DPE, Transnet and Alexkor) submitted performance reports that contained material misstatements. However, all of them managed to correct the misstatements as part of the audit process to ensure that the final published reports are free from material misstatements.

The table below provides a summary of the achievement of targets per entity, together with related insights.

Auditee	Material findings	Achievement of planned targets for 2021-22 (%)	Impact of targets not achieved
DPE	None	32 out of 35 (91%)	The impact on reported target is insignificant. The DPE performance targets did not include targets relating to the MTSF intervention for repurposing of SOEs – as such, we are unable to assess performance of the department on this element.
Transnet	None	17 out of 44 (39%)	Service delivery failure and losses incurred impacting going concern. Operational challenges that affected Transnet include the increase in security-related incidents, mainly cable theft and vandalism of rail and pipeline infrastructure; IT security challenges and the unrest in KwaZulu-Natal which largely impacted port and rail operations; tippler challenges at PE; the availability and reliability of locomotives; as well as the decline in the condition of rail infrastructure. The highest number of trains that were planned for the year were cancelled due to security incidents, which contributed to over 4 000 train cancellations. This has a significant impact on the profitability and sustainability of the entity.
Safcol	None	25 out of 29 (86%)	Future sustainability as projects enhance revenue streams. The target was not achieved due to the refocus in the implementation strategy based on the feasibility. The business case and a position paper recommended a feasible implementation option. The new strategy no longer considers a strategic partner that was supposed to deliver funding and a technical solution

Auditee	Material findings	Achievement of planned targets for 2021-22 (%)	Impact of targets not achieved
			together with the Execution Plan. The company will instead seek funding.

2.2.2 Value-added work / Emerging risks

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The DPE embarked on a process to sell 51% of its shares in SAA to a strategic equity partner (SEP). While the transaction is not yet finalised pending regulatory approvals, the AGSA reviewed the process followed and the agreement signed with the SEP to determine the impact on the DPE's financial statements. We did identify risks facing government with the transaction.

Overall observation

1. The purchase and sale agreement requires more than R3 billion to be paid by DPE to complete implementation of the BR plan. Funds to cover this liability have not been appropriated in the budget – potential non-compliance with section 38(2) of the PFMA. The related contingent liability was disclosed in the financial statements of DPE and we highlighted it in the audit report of the DPE as an emphasis of matter.

2. The department did not follow a formal process for the invitation, evaluation and adjudication of proposals from interested parties to identify the successful/preferred strategic equity partner.

    - No public invite for bids or expressions of interest
    - No evidence that proposals were fairly evaluated based on predetermined criteria.

3. The valuation report that was used to determine the transaction value was not timeously provided for audit purposes. This was only made during the last few days of the audit and we could not be able to perform all the required audit procedures thereon.

    The observations under (2) and (3) above were only included in the management report as the transaction is yet legally finalised.

Impact

The sale is part of the department's strategic goal to resuscitate the SAA. Should the sale transaction not be properly processed, it may result in further losses to the state or delays in making the entity fully operational. It is important to ensure that the transaction is advantageous to the state.

Cause

There are no clear legislative provisions for the disposal of SOEs, SOE non-core assets or SEP transactions. However, Treasury Regulation 16A3.1(b) requires the accounting officer to develop and implement an efficient and effective policy for the disposal of state assets. The DPE does not have a policy that regulates the disposal of shares in SOEs.

Recommendations

There is an urgent need to develop a clear regulatory framework for disposal transactions as government has plans to engage in more of these transactions.

Department to note the audit observations and determine impact on the ongoing transaction.

2.2.3 Material irregularities

Slides 11, 12 and 13

Definition: *A material irregularity means any non-compliance with, or contravention of, legislation, fraud, or theft or a breach of a fiduciary duty identified during an audit performed under the PAA that resulted in or is likely to result in a material financial loss, the misuse or loss of a material public resource or substantial harm to a public sector institution or the general public.*

Auditees in the portfolio scoped in (for auditees with outcomes)

	2021-22	2022-23
Auditees	Transnet Safcol	Transnet Safcol

Material irregularities identified during current year audit

Notified	Type	MI description	Status of MI	Status description
4 August 2021	Transnet: Financial loss	Contracts for the lease of heavy-duty plant and equipment awarded to bidder(s) that did not score the highest points - Non-compliance with section 2(1)(f) of the PPPFA and PPR 11(2).	The accounting authority responded to the MI and appropriate action is being taken.	Disciplinary process in progress.
4 August 2021	Transnet: Financial loss	Contract amounts exceed the tendered prices for the lease of heavy-duty plant and equipment - Non-compliance with section 2(1)(f) of the PPPFA and PPR 11(2).	The accounting authority responded to the MI and appropriate action is being taken.	Disciplinary process in progress.
18 August 2021	KLF (Safcol) Financial loss: Subsidiary	Penalty paid for underestimation of provisional tax.	MI under investigation.	We received the report of the independent investigation and are still assessing the outcome of the investigation to determine appropriate steps.
Notified	Type	MI description	Status of MI	Status description
4 August 2021	Transnet: Financial loss	Contracts for the lease of heavy-duty plant and equipment awarded to bidder(s) that did not score the highest points - Non-compliance with section 2(1)(f) of the PPPFA and PPR 11(2). Case: An award of R831 123 000 was made by the public entity in December 2019 for the leasing of front-end loaders, front-end loaders	The accounting authority responded to the MI and appropriate action is being taken.	Disciplinary process in progress, including an assessment of whether loss can be recovered from any party.

Notified	Type	MI description	Status of MI	Status description
		with pusher attachments, articulated dump trucks, tipper trucks, mobile fuel bowsers and excavators, for a period of five years to bidders that did not score the highest points, as required by section 2(1)(f) of the PPPFA and PPR 11(2). The awarding of the contract to more than one bidder without setting objective criteria to justify the awards is likely to result in a material financial loss as the public entity paid a higher price per item of equipment.		
4 August 2021	Transnet: Financial loss	Contract amounts exceed the tendered prices for the lease of heavy-duty plant and equipment - Non-compliance with section 2(1)(f) of the PPPFA and PPR 11(2). Case info: An award of R831 123 000 was made by the public entity in December 2019 for the leasing of front-end loaders, front-end loaders with pusher attachments, articulated dump trucks, tipper trucks, mobile fuel bowsers and excavators, for a period of five years. The contract amounts awarded to the bidders exceeded the amounts per the bidding documents submitted and included escalated prices even though price increase negotiations had not yet taken place.	The accounting authority responded to the MI and appropriate action is being taken.	Disciplinary process in progress, including an assessment of whether loss can be recovered from any party.
18 August 2021	KLF (Safcol) Financial loss: Subsidiary	Penalty paid for underestimation of provisional tax.	MI under investigation.	We received the report of the independent investigation and are

Notified	Type	MI description	Status of MI	Status description
				still assessing the outcome of the investigation to determine appropriate steps.

Observations and recommendations

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Observations from MI process

- Transnet MIs are taking longer to finalise because some of the implicated employees have disputed the allegations against them and are lodging an appeal on the disciplinary process.

Recommendations for portfolio committee

The committee may continue to perform oversight of the implementation of commitment made by accounting officer/authority in resolving MIs.

2.2.4 Findings on the audit of financial statements

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Auditee	Outcome	Material adjustments which could lead to a qualification
DPE	Unmodified	Completeness of contingent liabilities (DPE)
Transnet	Unmodified	• Investment properties (Fair value adjustments) (Transnet) • Related party transactions (Transnet) • Commitments (Transnet)
Safcol	Unmodified	No material misstatements identified

2.2.5 Financial health risk

Slide 17

Denel

- The DPE has reported that it is working with Denel to implement a long-term turn-around plan which requires restructuring. However, it appears that there are no clear plans to address the immediate liquidity requirements of the entity.
- As a result, Denel faced a number of court challenges during the year from employees and suppliers seeking to recover money owed to them. This is also the root cause of the R15,2 million unauthorised expenditure incurred by the DPE resulting from an unbudgeted transfer made to Denel to settle claims by suppliers.

SA Express (liquidated)

- The airline was formed to PROMOTE frequency of services on lower-density routes and to EXPAND regional air services capability in South Africa.
- Its liquidation left a gap that is yet to be filled in the market it served.

Mango Airlines (a subsidiary of SAA)

- The company is currently grounded and undergoing business rescue. This has left a gap in the low-cost traveller market which is currently under-serviced.

Government reforms

- Government has indicated that the future of state-owned companies is under consideration by the Presidential State-Owned Enterprises Council (PSEC) and that their continued existence will be informed by the value they create and whether they can be run as sustainable entities without bailouts from the fiscus.
- However, slow progress is being made with the implementation of key reforms, e.g. Shareholder Management Bill, funding criteria for SOEs, etc.
- This creates policy uncertainty in the SOE environment with SOEs struggling to deliver on their mandates (e.g. Denel).

2.2.6 Irregular expenditure analysis

Slide 24

During the year under review, auditees incurred irregular expenditure amounting to R1 234 704 000, of which R1 172 000 000 was incurred by Transnet. Due to the exemption, Transnet's irregular expenditure was not disclosed in the financial statements but was included in the integrated report.

2.2.7 Findings on compliance with legislation

Slides 22 and 23

The following material compliance issues were identified and reported:

Description	Root cause
Procurement and contract management (DPE; Transnet)	Senior management did not adequately review and monitor compliance with applicable legislation (DPE and Transnet).
Quality of financial statements (DPE; Transnet)	Senior management did not prepare regular, accurate and complete financial and performance information, which resulted to the material adjustments in the financial statements and performance report (DPE and Transnet).
Prevention of irregular, unauthorised and fruitless and wasteful expenditure (DPE; Transnet; Safcol)	Senior management did not adequately review and monitor compliance with applicable legislation, which resulted in the department incurring unauthorised and irregular expenditure (DPE, Transnet & Safcol).
Effecting consequences (Safcol; Transnet)	Management did not adequately implement monitoring processes to prevent non-compliance with laws and regulations relating to consequence management (Safcol & Transnet).

2.2.8 Internal controls

The significant deficiencies in internal control that led to the AGSA's overall assessment of the status of the drivers of key controls are described below.

Auditee	Leadership	Financial and performance management	Governance
DPE	Leadership did not adequately exercise oversight of financial and performance reporting and compliance with applicable laws and regulations.	Senior management did not prepare regular, accurate and complete financial and performance information, which resulted to the material adjustments in the financial statements and performance report.	None
Transnet	None	Senior management did not prepare regular, accurate and complete financial and performance information, which resulted to the material adjustments in the financial statements and performance report.	None
Safcol	None	Management did not adequately implement monitoring processes to prevent non-compliance with laws and regulations relating to consequence management.	None

3. Main root causes, recommendations and commitments for the portfolio

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All role players should continue to work together to strengthen the capacity, processes and controls of entities in the portfolio, which will enable credible financial and performance reporting, compliance with key legislation, sound financial management and improved service delivery.

Overall root causes of significant findings in Public Enterprises portfolio

Root cause	Recommendation	Commitment
Leadership did not adequately exercise oversight of financial and performance reporting and compliance with applicable laws and regulations (DPE).	More oversight required to ensure that SOEs' initiatives are realised and that annual financial statements are submitted on time. The DPE performance targets should include targets relating to the repurposing of SOEs with specific targets set.	
Senior management did not prepare regular, accurate and complete financial and performance information, which resulted to the material adjustments in the financial statements and performance report (DPE and Transnet).	Controls over preparation of financial and performance information at the divisions level need to be enhanced. The daily and monthly reconciliation review processes need to be emphasised at management division level to ensure errors are detected and corrected.	
Senior management did not adequately review and monitor compliance with applicable legislation, which resulted in the department incurring unauthorised and irregular expenditure (DPE, Transnet and Safcol).	Mechanisms to monitor compliance with applicable laws and regulations need to be revised to ensure their adequacy as non-compliance remains prevalent in the department and state-owned entities.	

Commitments by executive authority

Commitment	Status

4. Portfolio committee message

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Monitoring and regularly follow-up with the executive authority and accounting officer regarding the following:

- *There is an urgent need to finalise and implement the SOE reforms that have been announced by government, including the Shareholder Management Bill and SOE funding criteria.*
  - *This will ensure policy certainty and empower SOEs to delivery on their developmental mandates.*
- *The DPE's annual performance plan must be aligned to the MTSF targets of strengthen governance systems and ensure board stability.*
- *Key indicators and targets for the department must include outcome/output-based indicators which will see improvement of SOCs from year to year.*
- *Failure to submit financial statements is a contravention of the PFMA and the Companies Act. This further obstructs accountability and oversight processes.*
- *Decisive actions must be taken against the SOCs that failed to submit financial statements.*

Proposed commitments

Commitment	Date of commitment